



Arizona Utility  
Investors Association

2100 N. Central, Ste. 210  
P.O. Box 34805  
Phoenix, AZ 85067  
Tel: (602) 257-9200  
Fax: (602) 254-4300  
Email: swpr@amug.org



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EXCEPTION

BEFORE THE ARIZONA CORPORATION COMMISSION

JAMES M. IRVIN  
CHAIRMAN  
RENTZ D. JENNINGS  
COMMISSIONER  
CARL J. KUNASEK  
COMMISSIONER

IN THE MATTER OF COMPETITION IN THE )  
PROVISION OF ELECTRIC SERVICES )  
THROUGHOUT THE STATE OF ARIZONA )

DOCKET NO.  
RE-00000C94-165

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AZ CORP COMMISSION  
MAY 26 4 52 PM 1998  
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### NOTICE OF FILING

The Arizona Utility Investors Association hereby provides  
notice of filing exceptions to the recommended order of the  
Hearing Officer in the above-captioned matter.

DATED THIS 26TH DAY OF MAY, 1998.

*Walter W. Meek*  
WALTER W. MEEK, PRESIDENT

Original and ten (10) copies of the  
referenced Exceptions were filed this  
26th day of May, 1998, with:

Docket Control  
Arizona Corporation Commission  
1200 W. Washington Street  
Phoenix, AZ 85007

Copies of the referenced Exceptions  
were hand-delivered this 26th day of  
May, 1998, to:

James M. Irvin, Chairman  
Renz D. Jennings, Commissioner  
Carl J. Kunasek, Commissioner  
Paul M. Bullis, Legal Division  
Ray Williamson, Utilities Division  
Jerry Rudibaugh, Hearing Division  
Arizona Corporation Commission  
1200 W. Washington  
Phoenix, AZ 85007

Copies of this Notice were mailed this  
26th day of May, 1998, to all parties of record  
in the above-captioned docket.

Arizona Corporation Commission  
**DOCKETED**

MAY 26 1998

DOCKETED BY *Jmk*



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Phoenix, AZ 85067  
Tel: (602) 257-9200  
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# EXCEPTION

BEFORE THE ARIZONA CORPORATION COMMISSION

JAMES M. IRVIN  
CHAIRMAN  
RENZ D. JENNINGS  
COMMISSIONER  
CARL J. KUNASEK  
COMMISSIONER

IN THE MATTER OF COMPETITION IN THE )  
PROVISION OF ELECTRIC SERVICES )  
THROUGHOUT THE STATE OF ARIZONA )

DOCKET NO.  
RE-00000C-94-16

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AZ CORP COMMISSION  
MAY 26 4 53 PM '98  
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CONTROL

EXCEPTIONS  
BY THE ARIZONA UTILITY INVESTORS ASSOCIATION  
TO THE HEARING OFFICER'S  
RECOMMENDED OPINION AND ORDER

DOCKETED

MAY 26 1998

DOCKETED BY

## 1. Introduction

AUIA applauds the Hearing Officer's reasoned approach to the question of stranded investment. He has attempted to reduce a mountain of testimony to its simplest essentials and he has tried to resolve dozens of disparate and contradictory views in a manner that is fair to Affected Utilities and their investors yet meets the objectives of retail competition. In general, he has succeeded in his recommended opinion and order, but, of course, the Devil is always in the details.

AUIA supports the primary objectives listed by the Hearing Officer (P. 8, LL 11-17), including Objective A which would provide the Affected Utilities a reasonable opportunity to collect 100 percent of their unmitigated stranded costs. We agree that this is consistent with the results in other states that have decided this issue. We also support his conclusion that it would not be appropriate to reconsider previous management decisions which were determined by the Commission to be prudent at the time they were made (P. 8, LL 19-20, 26-28).

1 At the same time, we have serious misgivings about the proposed "sharing"  
2 concept (P. 9, LL 3-10). We appreciate the Hearing Officer's desire to provide  
3 incentives for Affected Utilities to mitigate stranded costs and we agree with  
4 his assessment that this proposal is less arbitrary than some of the sharing  
5 schemes suggested by other intervenors. It is arbitrary nonetheless, and our  
6 concern is that this proposal may act as an absolute barrier to achieving  
7 Objective A.

8  
9 AUIA believes the Hearing Officer is correct in separating the treatment of  
10 regulatory assets from that of generation assets (P. 12, LL 6-8) and he is also  
11 correct in his assessment that no one methodology will work for all Affected  
12 Utilities (P. 11, L 7). However, AUIA has major concerns about the  
13 application of Options 1 and 2, as discussed below.

14  
15 Finally, AUIA agrees with the Hearing Officer's reading of the Rules to mean  
16 that "it is already clear that stranded cost recovery will commence with the  
17 introduction of retail competition." (P. 15, LL 3-4). Any strategy to postpone  
18 stranded cost recovery beyond the start of competition would be irresponsible  
19 and unacceptable and would relegate retail competition to the courts.

## 20 21 **2. Stranded Cost Options**

### 22 **Option No. 1 - Net Revenues Lost**

23 Net revenues lost (NRL) was the preferred methodology offered by AUIA in  
24 its direct testimony. As such, we support the inclusion of this approach as  
25 one of the options. Specifically, the Hearing Officer recommends a modified  
26 NRL methodology similar to that presented by Arizona Public Service  
27 Company (P. 11, LL 11-26, P. 12, LL 1-15). However, the Hearing Officer asserts  
28 that the APS approach contains "a major flaw" in that customers would have  
29 little incentive to utilize another competitive supplier because "they would  
30 have to purchase generation at below market price in order to reap any  
31 savings."

1 In order to compensate for this purported flaw, the Hearing Officer proposes  
2 to put the utilities at greater risk for mitigation. First, he would use the  
3 customer base at December 31, 1998 to calculate stranded cost and would allow  
4 100 percent to be collected the first year, either through standard offer service  
5 or a Competitive Transition Charge (CTC). Thereafter, he would reduce the  
6 amount of stranded cost that could be recovered through the CTC by 20  
7 percent each year during a five-year transition period. The utilities'  
8 "opportunity" for full recovery would rely on two provisions: they would be  
9 entitled to the benefits of customer growth after 1998 and they would keep the  
10 savings from any future cost reductions.

11  
12 We are concerned about the methodology recommended by the Hearing  
13 Officer in several respects.

14  
15 First, we disagree that the APS methodology is flawed in the manner the  
16 Hearing Officer has described. Market price as it is used in the APS proposal is  
17 not the lowest spot price to be found but a market average. Buyers will be able  
18 to make purchases below that average. They are doing it today.

19  
20 Second, we do not believe that the recommended methodology will meet the  
21 stated objective of giving Affected Utilities a reasonable opportunity to  
22 recover all of their stranded costs. The mathematics of the Hearing Officer's  
23 proposal are that an average of only 60 percent of stranded costs assigned to  
24 customers in the competitive market could be collected through the CTC over  
25 the five-year period. That leaves 40 percent to be made up by future customer  
26 growth and cost mitigation efforts.

27  
28 AUIA does not believe that is achievable. There was no evidence submitted  
29 by any party in this proceeding to show that such a level of recovery could be  
30 accomplished through growth or mitigation or both. In fact, each witness  
31 supporting a so-called sharing proposal was asked under cross-examination to  
32 identify such sources of mitigation and none was able to do so.

1 The Hearing Officer proposes that customers who remain on standard offer  
2 service will continue to pay 100 percent of the stranded costs allocated to them  
3 during the transition period (P. 12, LL 3-4). However, an acceleration of the  
4 phase-in schedule, such as that proposed in pending legislation, could place  
5 all customers in the competitive market before stranded cost recovery is  
6 complete. If so, these customers would become subject to the CTC at the  
7 Hearing Officer's 60 percent level of recovery.

8  
9 Third, in our view the uncertainty surrounding this recovery program does  
10 not assure the revenue stream required for continued application of FAS 71  
11 and could result in significant writeoffs, particularly for those Affected  
12 Utilities which do not have an accelerated amortization schedule for  
13 regulatory assets.

14  
15 Finally, we object to the fact that the Hearing Officer makes no mitigation  
16 allowance for rate reductions that have taken place recently or that will take  
17 place during the stranded cost collection period. Both APS and TEP have  
18 pending requests for rate reductions and APS may well apply for a reduction  
19 in 1999. These rate cuts should be credited to stranded cost mitigation.

20  
21 In summary, it is doubtful that the Hearing Officer's approach to net revenues  
22 lost can achieve his stated objective of allowing Affected Utilities a reasonable  
23 opportunity to recover their stranded costs. It would make more sense and be  
24 more equitable to follow the APS method and apply customer growth, rate  
25 cuts and cost reductions as mitigation factors.

#### 26 27 **Option No. 2 - Divestiture/Auction**

28 As we made abundantly clear in our direct testimony and our cross-  
29 examination of various witnesses, AUIA is adamantly opposed to mandatory  
30 divestiture of generation assets as a means of determining stranded cost. We  
31 believe it is a short-sighted strategy which could, in fact, drive up energy costs  
32 and deprive Arizona consumers of reasonably priced electric generation.

1 The Hearing Officer's proposal (P. 12, LL 17-22) is not mandatory, but as a  
2 matter of first impression this proposal tilts the available choices in favor of  
3 divestiture because it is the only option that assures 100 percent stranded cost  
4 recovery.

5  
6 However, this proposal also contains flaws. Prescribing a levelized 10-year  
7 amortization without carrying charges or securitization could leave an  
8 Affected Utility with insufficient resources to meet its fixed obligations.

9  
10 In addition, divestiture could not be accomplished before Jan. 1, 1999, leaving  
11 the impact of stranded cost open to speculation at the start of competition.  
12 This could produce disastrous results for accounting applications and in the  
13 financial markets.

14  
15 Other aspects of the divestiture option are unclear:

- 16 • What comprises "non-essential generation assets?" Is this meant to  
17 exclude must-run units?
- 18 • Can an Affected Utility or an affiliate bid on the assets to be divested?
- 19 • What are "appropriate regulatory assets" and why should they be included  
20 in an auction? They have no value to a potential buyer and would simply  
21 drive up the price of generation assets.

### 22 23 3. Conclusion

24 In the Summary of the proposed order (P. 20, LL 7-8) the Hearing Officer  
25 concludes that "this overall scenario is only possible through continued  
26 growth in Arizona as well as increased efficiencies by the Affected Utility.  
27 Growth will help Affected Utilities mitigate potential losses of customers to  
28 competition."

1 This is a clear admission that the modified Net Revenues Lost formula  
2 recommended by the Hearing Officer depends heavily on sheer luck. No one  
3 knows if Arizona's population and business boom will continue. Certainly,  
4 the Affected Utilities cannot control the rate of growth.

5  
6 This is the regulatory equivalent of taking the equity represented by stranded  
7 costs to the nearest casino and tossing it on the crap tables. A roll of the dice  
8 would be a shameful reward for those whose investments in energy facilities  
9 have made Arizona's growth and prosperity possible.

10  
11 RESPECTFULLY SUBMITTED,

12 This 26th day of May, 1998

13  
14   
15 \_\_\_\_\_

16 WALTER W. MEEK, PRESIDENT